

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of 'the Appeal of)
RALPH AND PHYLLIS PAGANO)

For Appellants: Ralph Pagano,
in pro. per.

For Respondent: James C. Stewart
Counsel

O P I N I O N

This appeal is made pursuant to section 18593 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Ralph and Phyllis Pagano, against proposed assessments of additional personal income tax and penalties in the total amounts of \$2,729.00 and \$1,116.55 for the years 1967 and 1968, respectively.

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The sole issue presented by this appeal is whether losses incurred by "shills" in a card room business operated by appellant were deductible as business expenses or whether they were wagering losses, the deduction of which is limited by subdivision (d) of Revenue and Taxation Code section 17206. For purposes of convenience, only Ralph Pagano shall hereinafter be referred to as "appellant."

Appellant filed his 1967 personal income tax return three months after the due date of April 15, 1968; his 1968 return was filed approximately six months late. Appellant reported on his returns that he was self-employed and that he operated the Santa Fe Card Room in Emeryville, California. Appellant reported a loss from the operation of this business on the Schedules C included with his returns for both the years in issue.

The card room's revenue was generated from chair rentals. In order that there would be games available for the patrons, shills were employed who, when insufficient patrons were on hand, played in the card games. If a shill lost, the business absorbed the loss; if he won, he apparently divided his earnings with the business on a commission basis. Appellant provided the shills with the funds necessary to play.

Upon audit, respondent determined that the total receipts reported on the schedules attached to appellant's Schedules C revealed net, rather than gross, receipts. Appellant's daily cash records showed that he recorded the receipts from the chair rentals and then added or subtracted the net amount earned or lost from the funds provided the shills. Appellant deducted shill losses in the amounts of \$31,413.60 and \$20,196.46 for the appeal years, respectively. Respondent determined that these losses constituted wagering losses deductible only to the extent of wagering gains, and therefore added the deducted amounts to appellant's gross income. The subject proposed assessments, which reflect the allowance of a standard deduction not previously claimed, were subsequently issued. Although the proposed assessments include delinquent filing penalties, appellant has not disputed the penalties on appeal.

Appellant protested respondent's action; arguing that he was merely operating the card room as an employee and therefore should not be responsible for any additional tax liability arising out of the card room business. In addition he also argued that the shill

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losses constituted ordinary and necessary business expenses and were fully deductible. Upon consideration of appellant's position, respondent affirmed the proposed assessments, thereby resulting in this appeal.

Appellant's initial argument, i.e., that he was merely an employee of the license holder of the card room, is of no assistance to his position since it presumes that he is not entitled to the deductions disallowed by respondent. Moreover, the law is clear that skill losses of the type in issue here do not constitute "ordinary and necessary" business expenses, but rather losses generated from wagering transactions. (Nitzberg v. Commissioner, 580 F.2d 357 (9th Cir. 1978); Appeal of Estate of Edith C. Panuzzi, Deceased, Joseph O. Panuzzi, Executor, Cal. St. Bd. of Equal., Sept. 14, 1970; Rev. & Tax. Code, § 17206, subd. (d).) Accordingly, we must conclude that respondent properly disallowed the subject claimed losses to the extent that they exceeded wagering gains.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this **proceeding**, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of **the Revenue and Taxation Code**, that the action of the Franchise Tax Board on the protest of Ralph and Phyllis **Pagano** against proposed assessments of additional personal income tax and penalties **in** the total amounts of **\$2,729.00** and **\$1,116.55** for the years 1967 and 1968, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of April , 1983, by the State Board of Equalization, 'with. Board Members Mr. Bennett, Mr. **Collis**, Mr. Dronenburg, Mr. Nevins and Mr. Harvey present.

- William M. Bennett - - - - , Chairman

Conway H. Collis - - - - , Member

Ernest J. Dronenburg . - - - , Member

Richard Nevins - - - - , Member

Walter Harvey* - - - - , Member

*For Kenneth Cory, per Government Code Section 7.9